RIBA, TVM and Bai Al-Dain (Dayn)

The agonizing outcome of misunderstanding Riba

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INTRODUCTION

The review is an unintended shot triggered by remarks of an eminent scholar on Islamic Banking, and therefore a must read for those who are linked to Islamic Banking & Finance industry in a way. An attempt as well to draw the attention towards widespread misconceptions in money-for-money or pure money matters. Although the start of the article is very simple and straightforward but if you go through it, you may find some sense making out there down the lines.

The argument of IBF infancy is normally presented to defend different allegations; however, I don't see the basis of allegations in the immaturity of industry but the faults are located somewhere in fundamental concepts and unless these mistakes are not removed, it will be vulnerable and will not be possible to defend allegations even after several hundred years of infancy.

Islamic Banking is a reality of present time reached here after several attempts and experiences; it was always initiated with good intentions; to label it with bad names or calling it a fraud, does either show negative thinking or intentional propaganda. There are certainly deficiencies, problems and limitations the industry is facing on many fronts but to ignore its situational facts is not a justice; the lack of developing or finding a conceptual framework of IBF is the mother of almost all problems and allegations on the whole.

No proper direction of Islamic Banking is set as yet, profit and *maqasid* are not converging to fix a goal, on one hand more emphasize is given to product development which is not unnatural as well if seen from executive's point of view to run the business, whereas on the other hand choices for the development of products are reduced by rejecting any money-for-money dealing just because of the doubts on the subject of Riba that are removable.

The religious minds feeding the industry with compliant food and setting conceptual perimeter have their own backgrounds with limitations, they are not seen in efforts of discussing the issues and concepts publicly or at least with voices that are making little sense. I don't know if they are biased or live in fear, but the responsibility of doing wrong or doubtful persistently, is more on their shoulders than any one else.

There shall be no hesitation in pondering and discussing any mindset no matter how penetrated it is but with positive approach to address and solve problems and issues while keeping the original Islamic tenets in sight. If the mindset is wrong then it is wrong, and wrong must be corrected. When independent minds within the industry will start playing their role to bring a change or when the egoistic attitudes will not find a way to insist on their positions without arguments; at that time only, a change will be inevitable. May be the time has not come yet, but it will.

The Ambit of "Money For Money"

A contract or transaction for the exchange of money (for money) can basically be structured in two elemental forms, i.e., symmetrical (equal, even) and asymmetrical (unequal, uneven).

Symmetrical Exchange of Money

In any contract or transaction where money on both sides is equal whether there is any time frame involved or not, the contract or transaction is seen permissible (*Halal*) Islamically, and we don't see any debate or difference of opinion in this type of money exchange. The value matter of money due to inflation has its basic argument in disparity (inequality) and thus it is an issue of asymmetrical exchange. We may safely claim that there is a unanimous position across all Islamic schools of thoughts for the permissibility of symmetrical exchange of money, hence it is not the subject under discussion here.

Asymmetrical Exchange of Money

Unlike the simple and undisputed nature of symmetrical exchange, asymmetrical type is rather complex, excessively confused and widely debated sector of Islamic economics, the strict prohibition of Riba rules the segment primarily, and naturally thus the confusions and misconceptions in the understanding of Riba are well reflected in asymmetrical exchange.

In a very simplistic manner, let us do a little re-examination of the asymmetrical transaction, when unequl amounts of money are exchanged – there are <u>only</u> four possibilities as below:

A – Money X is exchanged with Money (X + Y) on spot
B – Money X is exchanged with Money (X - Y) on spot
C – Money X is exchanged with Money (X + Y) after a time 'T'
D – Money X is exchanged with Money (X - Y) after a time 'T'

Where 'X' is the principal amount, '+Y' is the increase, and '-Y' is the decrease in principal 'X'.

In figurative terms, replacing 'X' with '100' , 'Y' with '10' and 'T' with '1 year', it resolves to:

A – Given 100 and received 110 on spot
B – Given 100 and received 90 on spot
C – Given 100 and received 110 after 1 year
D – Given 100 and received 90 after 1 year

So simple the above illustrations are that you might have found yourslef uninterested or even skipped here without looking at it but wait a moment……, a massive confusion is built on this simple look when applying interpreted Islamic injunctions. Therefore, I would request you to take a reading break here and try to do your own analysis for each of four types and make up your mind now before moving next to identify / mark every one of the above types as '*halal*' or '*haram*'. It will be better if you have an argument or reason from Quran, Sunnah, or logic to support your marking, if you have – please keep it near with you, I may ask the same later if we don't match in identifying types. It is serious really if you care.

Thanks for doing like that, we may now move on - the transactions 'A' and 'B' are on spot or in zero time frame (i.e., simultaneous) while 'C' and 'D' involve a time period of one year, let us place them in two groups on the basis of their 'on spot' and 'time bound' features. I am leaving to discuss other grouping possibility for some other time.

Group 1 (Type A & B) : On Spot Asymmetrical

Remember, we are talking about pure money transaction, money for money on spot with a difference of amount. This difference of amount can not be attributed towards any time value of money (TVM) as there is no time factor present. So why the difference could be acceptable to the one who is receiving less? There are two possibilities that some one could agree to receive a lesser amount in exchange, first is a need (for example having a requirement of different denominations or another currency) and this need is encashed by his counterpart as an opportunity, whereas the second reason could be the speculation of receiver for getting any benefit out of this transaction in the future. A transaction is mostly originated either by a need or a greed.

The famous hadith of six commodities perfectly symbolizes 'On Spot Asymmetrical' situation and if we apply the general understanding or rules deduced by Islamic scholars from this hadith then it prohibits to undertake such transactions by disapproving unequal exchange on spot, hence the above two reasons of making some one's need as an opportunity or doing speculation are not valid Islamically. However, genuine needs must have some solutions but the prevalent understanding does not offer any in this situation (though subject hadith offers a lot more intelligence and wisdom where we may find a solution, but we are not discussing the hadith here and I intend to work with it seperately some times later).

The hadith classifies 'On Spot Asymmetrical' exchange as being a Riba transaction. So, in our present context we find two lessons from this hadith, firstly it condemns the above cited two reasons to undertake the transaction and secondly it clearly informs about the presence of Riba in it.

Assuming that the present rules deduced from this hadith are correct, hence let me mark two transaction A & B as '*haram*'. Check your marking, I hope we do match.

Important : It is imperative to note here, this hadith is referring to 'on spot' or 'simultaneous' exchange and there is not even a slight indication of 'time bound' exchange in it, hence we can apply the hadith of six commodities in 'On Spot Asymmetrical exchange' conditions only.

Group 2 (Type C & D) : Time Bound Asymmetrical

Here comes the core matter. A pure money transaction, money for money exchanged after a time period with a difference of amount, naturally the difference of amount in this case can be attributed towards a time value of money (TVM). Let us have a look on it again:

C – Given 100 and received 110 after 1 year
D – Given 100 and received 90 after 1 year

It is quite simple but still I would like to explain further by giving examples :

Suppose I lend an amount of $100 to a borrower and ask him to pay back $110 after 1 year, at the same time I lend another $100 to another borrower and ask him to pay back $90 after 1 year. By any stretch of imagination, the two transaction are not same.

If I am asking more, it is surely Riba and every one agrees to it. How, the second one could be classified as Riba where I am asking less than principal? There is no reference from Quran and Sunnah/Hadith I could find till now that points towards its categorization as Riba. I am not claiming a complete understaning of Quran or have gone through all Sunnah and Hadith but acknowledge all deficiencies that I possess, if some one knows a reference (that is being interpretated so) from sacred sources or have an argument in logic for the basis of identifying second type as being a Riba transaction, I would request him to share the same with me.

Defining Riba is not the purpose of this analysis, I have already explained my perception by giving a definition and rules to analyse a transaction for the element of Riba, and stick to that at this very point in time, hence let me classify the 'time bound asymmetrical' exchanges as:

1. Transaction type 'C' as '*haram*'
2. Whereas type 'D' as '*halal*'

Check your marking. Did you say both are '*haram*'? Ooops! We are not matching.

Ok, may I ask you now to unfold your reference, reason, or argument to mark 'D' as '*haram*'. I heard what you said "The hadith of six commodities, unequal amounts – no chance, this alone is enough to reject above marking" (there are more hadiths of similar contextual nature).

Well, you are not taking me seriously – the hadith is giving no rule for this situation, it was only applicable to 'On Spot Asymmetrical' exchange but this one is 'Time Bound'.

I listened your whisper "in Islamic economics, there is no time value of money, there is no possibility of money for money if amounts are different, and therefore 'time bound' is same as 'on spot' in money dealing".

Good enough, I read your mind but can not agree with you as I have good reasons to show where you are mistaken and therefore will try to convince you on my marking, let me first tell you plainly that your infancy will never end unless you accept this reason or provide yours to negate it because I find you in a very unfortunate state of affairs that will never lead you to a true progressing way, and will depict your situation as below:

You are on a cross-road of money business where there are only four roads connected to it in a roundabout fashion, by placing psychosomatic barriers - you have blocked all four pathways (A, B, C, & D - I would say at least one by mistake), where will you go now? Your journey will start only when you take an exit from the roundabout to make a progress at least on a path, or else you will be moving perpetually in the circle without any advancement, how long you can carry-on with this extravaganza? I don't know. See people watching you in the nearby, read their faces what they feel about you, are they calling you crazy or mad or showing some sympathy? When frustration builds to peek or if you can't face them any more, open the path that you have blocked by mistake and start your journey, but please do not go off-the-road (in katchcha) because you will be lost there completely.

By the way, there is another cross-road of money but that is without any business, you know what I mean ‘symmetrical exchange of money’, you may visit this just for a change. But you have not taken an exit from the first, how will you reach here if you were born there?

You may or may not like my portrayal, but this is what I feel your situation be – roughly as it is or more if you can read between the lines.

Before I can indicate the oversight, let me briefly describe some of the circumstances that are facts seen or noticed across IBF industry today, then will extract and highlight <u>few key notes</u>.

<u>Your Relationship with Depositors</u>
Your silent partners from whom you take deposit in the form of money and pay them back with profit or loss (if ever incurred), what you do with their money to generate profit has nothing to do with your depositors except your fundamental understanding with them that whatever you do will be in a manner that Islamic tenets allow you to do – other than this, it is your separate, internal and discretionary affair. When you make/loose money in your business dealings, you share the profit/loss with your depositors and pay them accordingly at the end of your accounting cycle. If you follow Islamic tenets (as you are suppose to), then profit or loss would be real. Since the release of accounting statement is only workable in a cyclical time domain thus naturaly the profit/loss measure is also related to time. How much in how much time, the market will automatically set some standards for the rate of return in percentage figure of profit over deposits, it is the time value of money for your depositors.

There is nothing unislamic here if rate of return is specified as the time value of money.

<u>Real Transactions</u>
In a contract such as Murabaha, you have a role of facilitating the transaction that is actually planned between two external entities i.e, buyer and seller of an asset. In reality, your role is because of money and not because you own the asset to sell or buy the asset to use. If buyer and seller execute the deal in cash without your assistance, they agree on one price of asset, however if the buyer does not possess money (or do not want to use his money because of his own reasons) and insert your role then the price he has to pay after agreed period is more than what he had to pay in cash. The price on two points in time is changed (increased) by induction of your money, asset is same, therefore this change in price can’t be attributed towards asset or some other thing but the time value of money only, it is very Islamic way.

Any body who possess money can acquire this role if he is able to judge profitability from the transaction, so let us exclude Islam from the panorama for a while and put emphasize on business facts. If the buyer and seller are genuine and agreed on sale/purchase of the asset but the transaction is waiting for money to realize – it is a perfect business opportunity for any one who possess money, now if money provider trusts other involved parties in this deal and finds it profitable in his estimation, then he would like to avail the opportunity for a gain in money he possess. Every one involved in this business has to ensure and guard their own benefits by themselves. It was not only asset that invited to undertake the business but a number of other factors, common in them all was the genuineness (real substance) of every element namely buyer, seller, asset, need, money, you/him and the profitability. Real things are real infact. The catch in this transaction is not the asset but the real nature of business.

The above bona fide situation is definitely not a Riba scene, if all other Islamic considerations like '*halal* asset' are confirmed then the whole deal is '*halal*' Islamically. If the asset traded is not permissible in Islam then the deal will be tendered as '*haram*', similarly while negotiating, if you deceit or lie to buyer by showing him your overhead cost more than the real just to increase your profit margin, or any other disclosure that is not truthful, the deal will become '*haram*' for you alone despite the fact that the asset was '*halal*'. Similarly, if the buyer or the seller is dishonest in revealing required information, it will be '*haram*' to him in that order.

This is a real opportunity in an Islamic outlook, in order to make it '*halal*' for you, <u>real</u> Islamic treatment of the opportunity is required from you to follow. I would even say - if a contract lasts over a period of time, it must have a quality that at every point in time over the period of contract, nothing in contractual substance shall have the potential to turn unrealistic, this is the desired Islamic essence present in all Islamic codes. The artificial and unrealistic nature of Riba element is the basic reason of its prohibition thus every contract involving Riba is an unrealistic transaction by nature.

The precondition of any transaction in an Islamic perspective is the real nature of it in every respect, not mere asset.

<u>Artificial Transactions</u>

Now you have another opportunity of offering money to a customer who is in need to meet his running expense – the need, your customer, you and your money all are genuine. There are definitely few ways that you both can agree on real things to work out a solution, but at this time you can't design a true Murabaha contract because there is no real need of buying asset, no real buyer or seller, however if you attempt to put one in place, in this case you will assign your customer a role of the buyer and the seller of his own asset or fake asset, by any standard it will be an artificial contract in its nature and only '*halal* asset' can not make the whole deal '*halal*'. Practically you are extending loan to the customer and getting return on it that will be termed as Riba by many sensitive judgments.

Like incompatibility of Murabaha in above situation of running expense, there is no pragmatic application of other Islamic contracts here such as Salam or Istisna, I don't find the leeway in any Islamic contract to fit here for <u>external financing</u>, every such effort is fake and will make the dealing '*haram*'. Islamic Banking industry is paying a huge price for such manipulations in terms of sacrificing its image and reputation and above all damaging the idealogy by falsely portraying the inability of the doctrine in offering real solutions.

This again is a real opportunity from Islamic outlook, but a potential Riba scene, a fake type of contract will spoil the opportunity by converting it into a practical Riba transaction and thus '*haram*', however if you do not agree for Riba in it by calling it asset based transaction, even then the disclosures in contract (which are fictitious) are enough to make it '*haram*'. You are not treating a real opportunity in a real Islamic way.

Can you be fit there without spoiling the opportunity? There are few possibilities like:

1. By acquiring factual stake (share/equity) in ownership of your customer's business.
2. By buying his genuine accounts receiveable at some discount.

The first choice is generally considered difficult, more risky, legalistic, and ineffecient, so it is hardly doable option.

The second option consist of a real object and shall be considered instead of artificial ones, as per my perception and definition, there is no Riba in discounting the real capital of the future and this efficient and real handling option of the opportunity is wrongly forbidden due to the misconception of Riba (a prohibiting the permitted case). If you treat the opportunity in this way, every aspect of the transaction is real and the deal will be '*halal*'.

Discounting was previously considered invalid Islamically but now it is a disputed option, let us have a brief look at the dispute in Bai Al-Dain (Dayn) i.e., Trade of Debt, case.

The Case of Bai Al-Dain (Dayn)

In Malaysian Islamic Banking industry of today, Bai Al-Dayn is considered a permissible act by many of them, whereas scholars like Justice Taqi Usmani and other Middle Eastern people influencing significant industry segment do not agree to Malaysian position on this issue.

The misunderstanding of Riba is reflected in both disputed positions, the Malaysian argument as projected seem to be in the efforts of creating a link of the 'trade of debt' transaction with the commodity once associated with this debt, the commodity contract is already concluded and debt is created as a result, then how in a fresh and totally separate transaction – it can make a sense to associate it with commodity not present (not real) in the picture. Malaysian argument for permitting Bai Al-Dayn is therefore rejected by the counterpart faction. Finding reason in asset is a result of misconception that Islamic Banking is only asset based, this is one critical hurting outcome of misunderstanding Riba.

In my perception, any financial reality of the future like debt, bill of exchange etc. can be discounted at a lower than its face value price of the future. Whereas the 'trade of debt' means that debt can be sold at higher or lower price, the higher price will constitue Riba but lower price does not contain Riba.

Although, Malaysian reason is not valid at all but the position on permissibility they have taken is half correct i.e, if applied in discounting only and not in trade of debt, the reason for the permissibility of discounting falls in the concept of Riba or the rationale for the prohibition of Riba that I used to employ.

On the other hand, I would like to quote the position of Justice Usmani:

Quote"

In fact, the prohibition of bai'-al-dain is a logical consequence of the prohibition of 'riba' or interest. A 'debt' receivable in monetary terms corresponds to money, and every transaction where money is exchanged for the same denomination of money, the price must be at par value. Any increase or decrease from one side is tantamount to 'riba' and can never be allowed in Shari'ah.

"Unquote

Ref : http://www.darululoomkhi.edu.pk/fiqh/islamicfinance/islamicfinance.html

'Any increase **or decrease**' - bold is an extra and casual representation of hadith text, I have not seen this impression or text anywhere in all those hadiths including their popluar versions that are normally cited with Riba-al-fadl's description.

The poor argument (*dalil*) like "one's decrease is other's increase" is very dismal logic indeed where no consideration is given on the relationship of the two entities in changed conditions, its dynamics and economic behaviour of the transaction. I have already given few differences in loan and discounting comparison on my website and intend to present few more separately when discussing hadiths on Riba. I entirely reject this type of argument and have not seen a reasonable explanation/logic from anyone showing that both 'increase or decrease' are same, it is just a position derived by an ingenuous appraisal.

Infact, this is representing the present mindset of Islamic Banking Industry that is highlighted in this review; standstill status, exhibiting no possibility of money for money with a difference of amounts. A psychosomatic barrier that has blocked all real possibilities and has opened the doors for forgery, imitation and tricks. Riba is misunderstood and misinterpretated here that is preventing the evolvement of a conceptual framework for Islamic Banking, in the presense of this mistaken belief, the wish for a paradiam shift in Islamic Finance will be a dream. I am afraid, desiring to establish Islamic Money Market with this mindset, do you really have a clear idea as what you intend to do?

The discounting of Future Real Capital has great potential to offer a powerful mechanics not only for 'Islamic Money Market' but for 'Islamic Bench Marks' and 'Islamic Monetary System'. The applications of discounting in present system have reasonable scope for IBF operations, but if it were possible to modify corporate laws a little and then combining with discounting dynamics, it can produce highly efficient '*halal*' solutions for businesses, and Islamic Banking & Finance industry making a path for vibrant and justified economic system.

While we're on the subject and before I forget, will add – the idea of 'Islamic Money Market' is not very good in principal and instead it will be more practical and representative of IBF to form an "Islamic Equity Market" (or any other symbolic name) where asset, equity and Future Real Capital shall be exchanged, there are so many possibilities in combinations that are difficult to envision and list here.

The Oversight (Mistake)

All economic affairs in Islamic perceptions are sensitive in differentiating between permitted (*halal*) and prohibited (*haram*), Riba is just one form of prohibition but the most stringent one as compared to other prohibitions. As a result of strictness in the prohibition of Riba, utmost care has been taken by religious scholars while interpretating sacred sources, thus doubtful has been categorized in to '*haram*' – a demand of faith to treat the doubtful. The above case of Bai Al-Dain (Dayn) precisely articulates doubts in the understanding of Riba. Islamically, principally, and logically – doubts unless not settled shall be discussed until removed.

If any thing is '*haram*' in Islam – it is definitely because of some reason, the reason might be itself in the substance or the process due to its effects/results, or it produces an undesireable effect/result not good for humans in certain condition, hence we see some things are '*haram*' regardless of any condition i.e., only due to the reason contained within themselves and then we notice several things are '*haram*' if specific condition is met but are '*halal*' otherwise.

The divine law of '*halal*' and '*haram*' is based on reasons either known to us or not, in some exceptional circumstances, '*haram*' of normal conditions become '*halal*' but that is again due to some reason like giving highest priority to saving a life instead of observing normal code of '*haram*' in that very situation.

Reasons and conditions – are two significant dimensions in the classification of '*halal*' and '*haram*' that can be explored to study and remove doubts from prevailing misunderstanding or misconceptions of respective injunctions.

The case of Riba calls to find its reasons and conditions of prohibitions, if truth be told – it is more serious and demanding today than ever before because a whole group of instituitions following the doctrine of avoiding Riba has no future without its resolution.

The practice of Riba at the time when it was prohibited, Quranic and Prophetic descriptions of Riba and the sense it carries from different interpretations by scholars; from all these sources we find a verifying common condition for sure that Riba is in increase. If you study the text of any or all hadiths, you will not get an impression or phraseology directly saying that Riba is <u>in decrease</u> or <u>also in decrease</u> but you will definitely find an impression and the choice of words indicating increase as a condition of Riba. This is the oversight (mistake) if one miss to see. It is imperative to apply condition that is only stipulated.

The reason that I employ for the prohibition of Riba has its condition only in increase and not in decrease, and conforms to all sacred revelations without adding or changing their sense; but when decrease is grouped with increase in defining Riba, it is an addition to the condition which is not stipulated anywhere except in few interpretations. This is the misjudgement and rather more when no reason or logic is given for it.

<u>Few Key Notes</u>
Summarizing the subject matter in few key notes as under:

1. There is a Time Value of Money (TVM), it is not correct to assume otherwise because the practices and contracts permissible in Islam do exhibit this merit of money, we can however say that there are <u>Islamic Ways</u> to incorporate TVM in economic transactions (*muamlaat*).

2. Future Real Capital has all reasons for discounting without any element of Riba in it.

3. Defining and calling Islamic Banking as 'asset based' is not a proper tagging or class, in my view the scope of Islamic Banking is limited to the following:

   Islamic Banking = Money Applications in Reality, or
   Islamic Banking = Conventional Banking (MINUS) Artificialism

   However, to claim this – it is prerequisite to remove all present day artificialism that is implemented in the name of infancy. Any Riba or fake transaction will automatically go out of the scope with above convention. Just think about the application of money in reality, it will expose what does it mean.

*** End ***